

**D.**

**Texas Department of Banking**

**Industry**

**and**

**Departmental Operations**

**and**

**Legislative Activities**



Charles G. Cooper  
Commissioner

## TEXAS DEPARTMENT OF BANKING

2601 North Lamar Blvd., Austin, Texas 78705  
512-475-1300 / 877-276-5554  
[www.dob.texas.gov](http://www.dob.texas.gov)

To: Finance Commission Members

From: Kurt Purdom, Director of Bank & Trust Supervision

Date: May 31, 2012

Subject: Summary of the Bank & Trust Supervision Division Activities

Bank and Trust Supervision					FY 2012							
FY2010			FY2011		1 <sup>st</sup>		2 <sup>nd</sup>		3 <sup>rd</sup>		4 <sup>th</sup>	
Industry Profile (# / Assets (billions))												
# Banks	316	\$161.9	307	\$159.4	304	\$168.4	302	\$170.3	301	\$175.4		
# Trust Co. (1)	20	\$17.4	22	\$20.4	22	\$19.1	22	\$20.4	22	\$21.9		
# FBA/FBB	10	\$73.5	10	\$97.5	10	\$97.9	10	\$93.0	10	\$95.0		
Examinations Performed												
Banks	171		169		38		39		*			
Trust Co.	48		37		8		6		*			
FBA/FBB	3		5		1		1		*			
Bank CAMELS (# / %)												
1	120	38.0%	116	37.8%	111	36.5%	115	38.1%	119	39.5%		
2	139	44.0%	140	45.6%	145	47.7%	140	46.4%	136	45.2%		
3, 4, & 5	56	17.7%	51	16.6%	48	15.8%	47	15.5%	46	15.3%		
Non-Rated	1	0.3%	0	-	0	-	0	-	0	-		

\* Third quarter fiscal year 2012 performance measure data hasn't been finalized but will be provided in the next summary.

(1) Fiduciary assets for non-exempt trust companies only.

The Department considers any bank with a Uniform Financial Institutions Composite Rating of 3, 4, or 5, to be a problem institution. We anticipate that the number of problem banks, currently at 46, will slowly decline as problem banks are able to resolve their troubled loans, and holdings of other real estate are liquidated.

May 31, 2012

Administrative/Enforcement Actions (Number outstanding as of the date indicated)		FY 2012				
	8/31/2010	8/31/2011	11/30/2011	2/29/2012	5/31/2012	8/31/2012
<b>Banks - Safety and Soundness</b>						
Formal	17	18	18	16	16	
Informal	57	53	56	58	57	
<b>Banks - Bank Secrecy Act (BSA)</b>						
Formal	1	1	1	0	0	
Informal	4	1	1	1	1	
<b>Banks - Information Technology (IT)</b>						
Formal	0	0	0	0	0	
Informal	4	3	3	4	3	
<b>Trust Departments of Banks and Trust Companies</b>						
Formal	0	0	0	0	0	
Informal	1	1	1	1	1	
<b>Total Administrative/Enforcement Actions</b>						
Formal	18	19	19	16	16	
Informal	66	58	61	64	62	
<b>Total</b>	<b>84</b>	<b>77</b>	<b>80</b>	<b>80</b>	<b>78</b>	

Formal actions include Orders to Cease and Desist, Consent Orders and Written Agreements.

Informal actions include Determination Letters, Memoranda of Understanding, Commitment Letters and Board Resolutions.

Orders of Supervision, Orders of Conservatorship and Compliance actions are not included.

Compliance with Examination Priorities (Past Due Examinations)			
Entity Type	02/29/2012	03/31/2012	04/30/2012
<b>Commercial Banks</b>			
Total by Responsibility (TDOB/FDIC/FRB)	8/8/0	9/5/1	12/8/2
IT	2/8/0	1/5/1	5/8/2
Trust	1/0/0	0/1/0	1/2/1
<b>Foreign Bank Agencies</b>			
Total by Responsibility (TDOB/FRB)	0/1	0/1	0/1
<b>Trust Companies</b>			
Total by Responsibility (DOB Public/Exempt)	0/0	0/1	0/1
IT	0	0	0
<b>Total of All Entities</b>			
Total by Responsibility (TDOB/FDIC/FRB)	11/16/1	11/11/3	19/18/6
<b>Total</b>	<b>28</b>	<b>25</b>	<b>43</b>

Of the twelve banks that are past due for examination for the Department as of April 30, 2012, five were started in May and the remainder except one is scheduled for an examination by June 19, 2012. Based upon the current examination schedule, the average number of days these examinations will be delayed past their due dates is 59 days.

**Division Highlights**

- Seminar/Panel/Conference Participation:
  - Regional Directors and field examiners assisted in a presentation at the Department's staff conference held in Austin. The presentation, entitled "Red Flags Indicators," addressed some of the unique troubled bank circumstances that have been encountered by examiners in the last year and the early warning indicators that pointed toward problems. Also, Deputy Commissioner Bacon and Director Purdom participated in a presentation about the process for commissioning commercial examiners. (4/9 – 4/12)
  - Director Purdom participated in a regulator round table presentation at the Risk Management Associates' Texas Chapter Spring Conference. RMA provides various educational services to bankers. (4/27)
  - Review Examiner Wu joined representatives from the Federal Reserve, FDIC, and OCC in a regulatory panel discussion at the Texas Bankers Association Compliance Conference. (4/27)
  - Commissioner Cooper, Deputy Commissioner Bacon, Regional Director Walker and Regional Review Examiner Myers attended the Texas Bankers Association Annual Conference in Fort Worth. This conference included presentations on current economic and regulatory topics. In addition, the Department maintained an informational booth that was operated by staff members. (5/9 – 5/11)
  - Commissioner Cooper, Deputy Commissioner Bacon, Director Purdom, Regional Directors Walker and Holt and Financial Analyst Lena attended the CSBS State-Federal Supervisory Forum in Savannah, Georgia. The forum included presentations on current economic conditions and regulatory issues, and provided opportunities for discussion of these topics with officials of state and federal regulatory agencies. (5/20 – 5/23)
  - Review Examiner Kevin Wu continues to participate in the SAGE Project. This is a cooperative effort between the FDIC, CSBS and several state banking agencies to revise and upgrade the existing software used as an examination work program and report processing. In recent weeks, this has involved weekly conference calls on the progress of the project. Additionally, in June, Kevin will join several representatives from other states to participate in testing of the Alert Program, which is the automated loan review feature of the work program.
- Federal Programs:
  - TARP – Eighty of our banks applied to participate in the Capital Purchase Program under the Troubled Asset Relief Program (TARP). However, after significant withdrawals, only 21 banks received funds totaling \$2.8 billion, with one bank receiving about 80% of this total. As of May 8, 2012, nine banks have not repaid any of their TARP funds. The total outstanding amount is approximately \$311 million.
  - Small Business Lending Fund (SBLF) – Twenty-three Texas state-chartered banks applied for funds under this program. Twelve banks received funds totaling \$255.7 million. The remaining banks either withdrew their applications or their applications were denied. As of May 7, 2012, all funds are still outstanding.



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Commissioner

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To: Finance Commission Members

From: Daniel Frasier, Director of Corporate Activities **DBF**

Date: May 31, 2012

Subject: Summary of the Corporate Division Activities

Corporate Activities		Applications and Notices Processed					
Entities	FY2010	FY2011	3Q11	4Q11	1Q12	2Q12	3Q12
*Banks and bank-related (holding companies, etc.)	259	212	66	46	49	48	**
Foreign Banks	5	6	1	3	3	1	**
Trust Companies	19	18	6	4	1	2	**
MSBs	19	14	3	3	6	5	**
PCSEAs	11	15	1	4	4	1	**
CVES	5	4	0	0	0	4	**
Other (Use of Name)	59	62	10	18	10	19	**
Totals	377	331	87	78	73	80	**

Entities/Activities	Application and Notices Under Review (as of May 29, 2012)
*Banks and bank-related (holding companies, etc.)	16
Foreign Banks	1
Trust Companies	3
MSBs	4
PCSEAs	0
CVES	0
Other (Use of Name)	3
Totals	27

\*Includes all types of applications and notices for each entity.

\*\*Complete information is not available for the current fiscal quarter. This information will be reported at the next Finance Commission Meeting.

### Division Highlights

- The overall volume of applications processed has ebbed a bit over the last quarter. Money Services Businesses applications have normalized as compared to the elevated pace we have seen this past year.

Finance Commission Memorandum  
Corporate Activities

- Frost National Bank's conversion application was approved on May 30<sup>th</sup>. While we have seen a marked pickup in inquiries about conversions, we have not received any other conversion applications.
- Chartering, Conversion, and Merger Activity – The following transactions were consummated so far during the third quarter of the 2012 fiscal year:
  - *Banks*
    - American Bank of Texas, N.A., Marble Falls, merged with and into American Bank of Texas, Sherman
    - The Bank Arlington, Dalworthington Gardens, merged with and into Prosperity Bank, El Campo
    - I Bank Texas, SSB, Austin merged with and into Independent Bank, McKinney



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To: Finance Commission Members

From: Russell Reese, Director of Special Audits 

Date: June 1, 2012

Subject: Summary of the Special Audits Division Activities

Special Audits					FY 2012							
Entity	FY2010		FY2011		1 <sup>st</sup>		2 <sup>nd</sup>		3 <sup>rd</sup>		4 <sup>th</sup>	
Industry Profile (# / Assets (billions) )												
MSB	130	\$71.5	128	\$80.7	130	\$81.1	131	\$81.0	135	\$81.1		
PFC	404	\$2.96	396	\$3.1	396	\$3.09	398	\$3.1	398	3.1		
PCC	244	\$238.3	245	\$239.9	243	\$239.0	243	\$257.2	243	257.0		
PCSEA	12	n/a	10	n/a	10	n/a	10	n/a	10	n/a		
CVE	4	n/a	4	n/a	4	n/a	4	n/a	4	n/a		
Examinations Performed												
MSB	94		106		25		14		**			
MSB Limited Scope	3		0		4		0		**			
MSB Accepted other State	5		3		0		0		**			
PFC	260		285		40		68		**			
PFC Limited Scope	11		3		4		2		**			
PCC	237		173		67		68		**			
PCC Limited Scope	9		3		2		4		**			
Ratings (# / %) Assigned to All Regulated Entities												
1			317	42%	298	39%	278	37%	275	36%		
2			363	48%	360	48%	364	48%	369	49%		
3,4, & 5			78	10%	99	13%	113	15%	114	15%		
Noncompliance with Examination Priorities (Past Due)												
MSB	6		5		3		9		**			
PFC	3		29		35		22		**			
PCC	5		69		42		17		**			
Enforcement Actions												
MSB	1		2		0		0		0			
PFC	6		7		1		2		2			
PCC	6		1		0		1		2			
PCSEA	1		0		0		0		0			

## NOTES:

PCC \$ amounts reflected in the millions.

Limited scope examinations do not receive a rating.

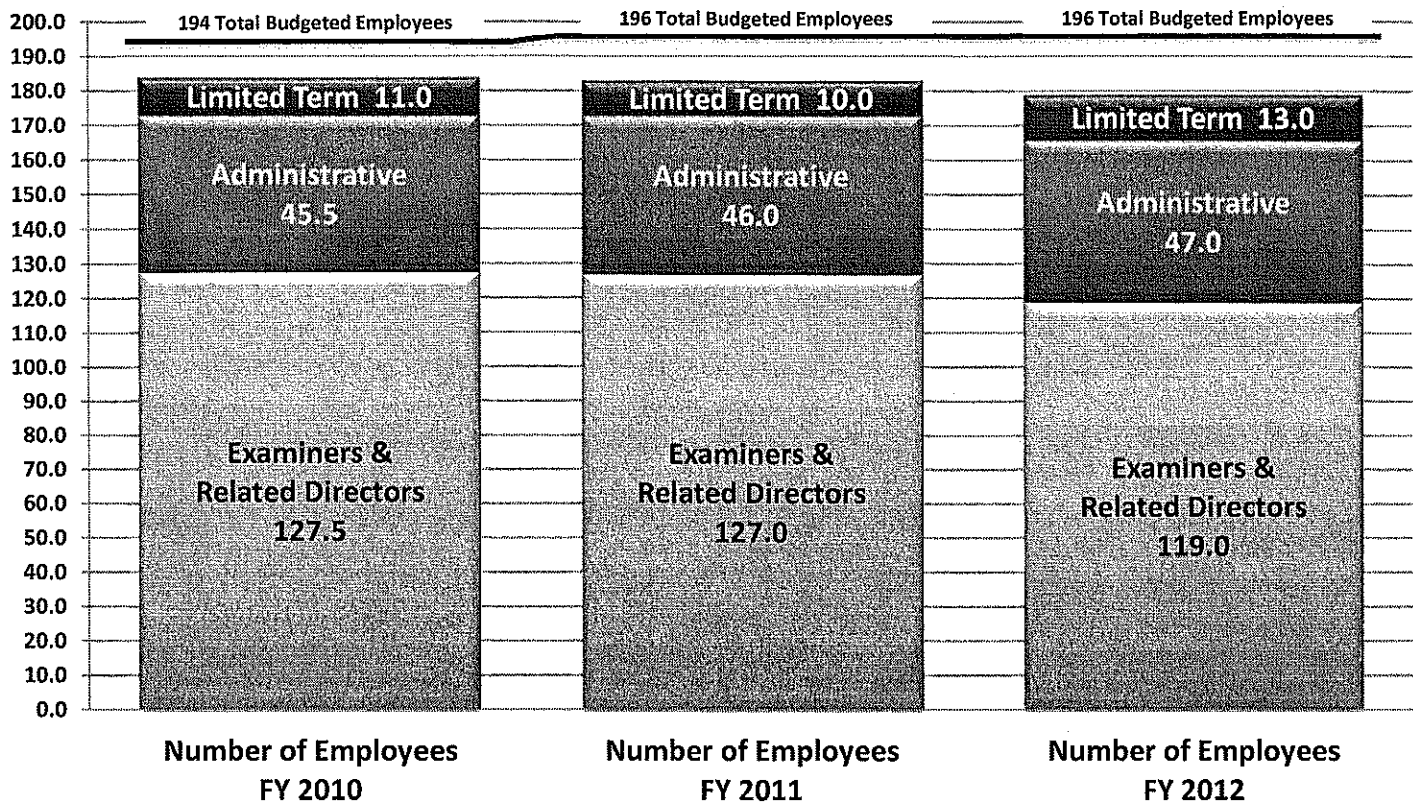
\*\* Third quarter fiscal year 2012 data has not been finalized and will be provided in the next summary.

**Division Activities:**

- A PFC/PCC Financial Examiner resigned on May 22, 2012. We currently have a job posting to fill this vacancy and anticipate interviewing applicants in the near future.
- On April 25<sup>th</sup>, Deputy Commissioner Newberg gave a presentation on PFC regulations at the Waco Vital Statics Funeral Directors Continuing Education Symposium in Waco, Texas.
- During the week of May 7<sup>th</sup>, Director Reese and Senior Examiner Gonzalez were instructors at a training seminar for regulators of money services businesses during MTRA's Intermediate Examiner School in San Diego, CA. Thirty-seven examiners from sixteen states attended the school.
- A Prepaid Funeral Guaranty Fund Advisory Council (Council) meeting was held on May 17, 2012. The Council approved a Trust Guaranty Fund claim totaling \$1,535.00 related to Walker-Mora Funeral Home, Alice, Texas.
- On May 23<sup>rd</sup>, Director Reese gave a presentation on PFC regulations at the East Texas Funeral Directors Continuing Education Symposium in Tyler, Texas.
- On June 13<sup>th</sup>, Director Reese will give a presentation on prepaid funeral contract (PFC) regulations to members at the Texas Funeral Directors Association's (TFDA) annual convention in Arlington. Director Reese will also staff a booth at the convention which provides an additional forum to communicate changes and other important information to the industry.

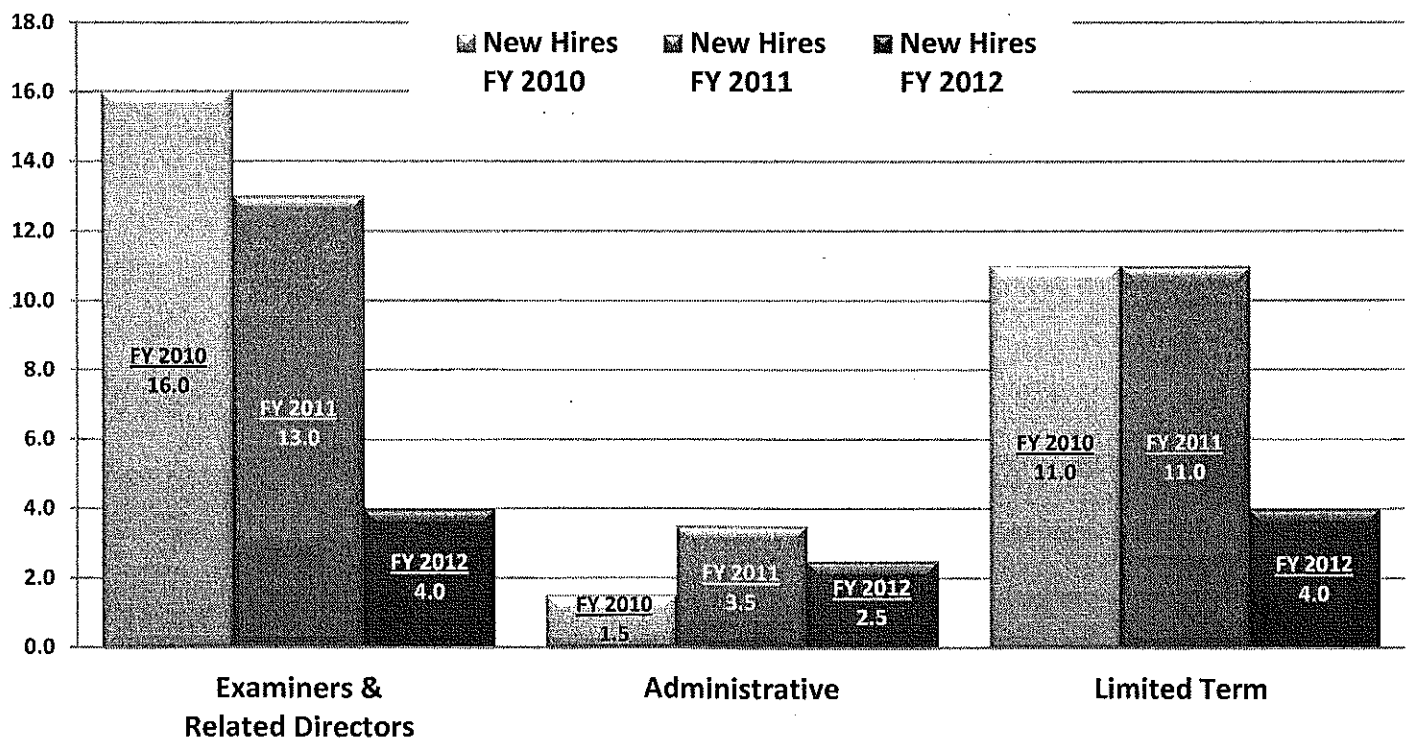


## Texas Department of Banking Employee Data for Fiscal Years 2010, 2011 and 2012



*As of 5/31/2012*

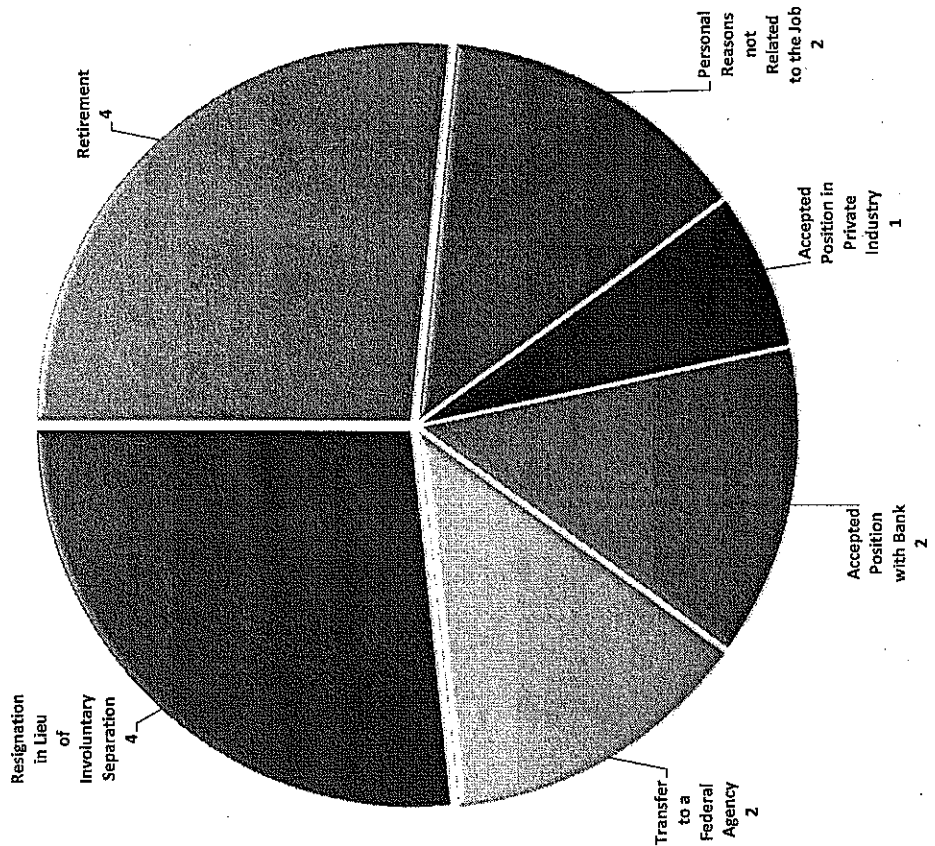
## Texas Department of Banking New Hire Data for Fiscal Years 2010, 2011 and 2012



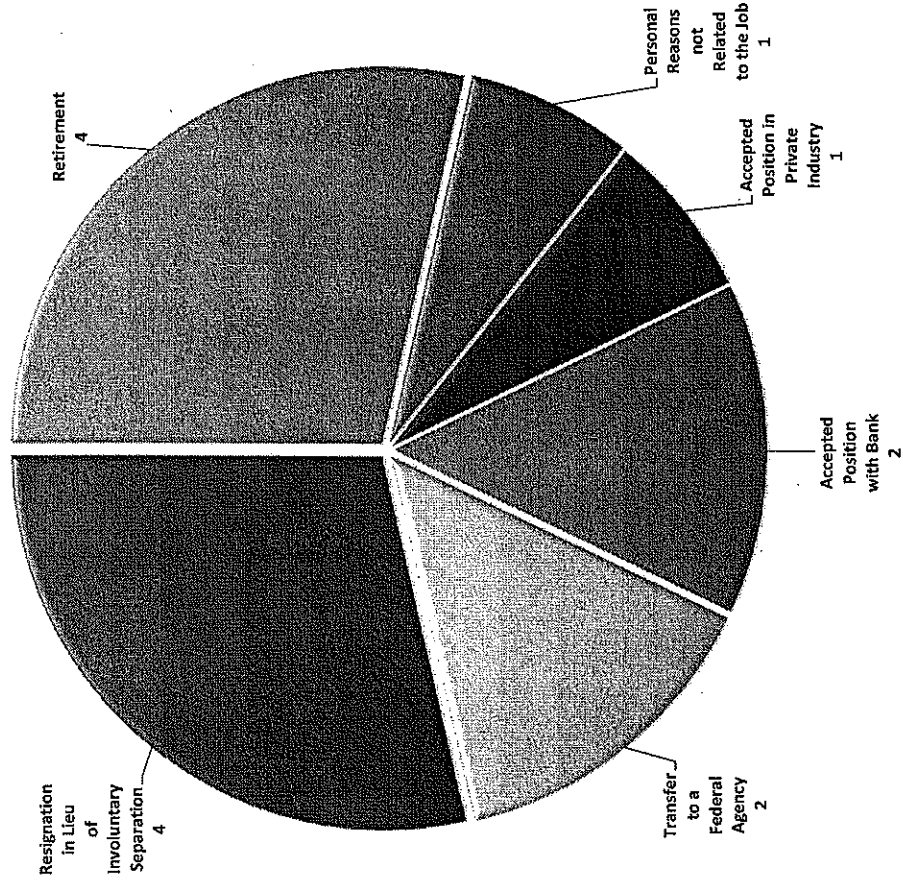
*As of 5/31/2012*

# **Texas Department of Banking** **FY 2012 Employee Turnover**

FY 2012 Employee Turnover Reasons  
 As of 5/31/2012  
 All Employees  
 15 Resignations



FY 2012 Employee Turnover Reasons  
 As of 5/31/2012  
 Financial Examiners Only  
 14 Resignations





Charles G. Cooper  
Commissioner

## TEXAS DEPARTMENT OF BANKING

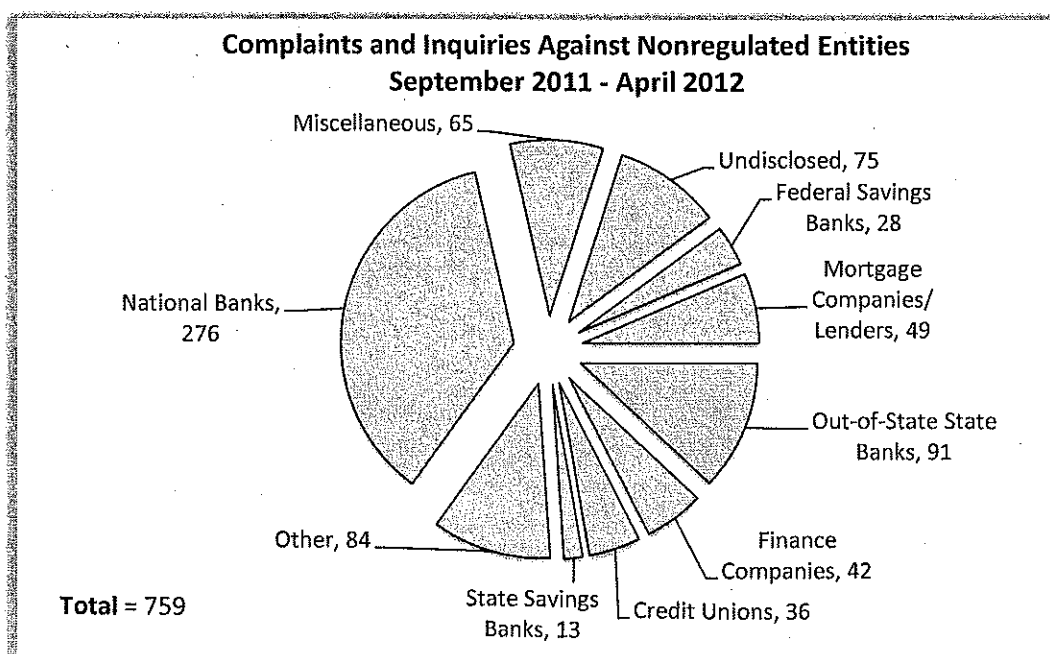
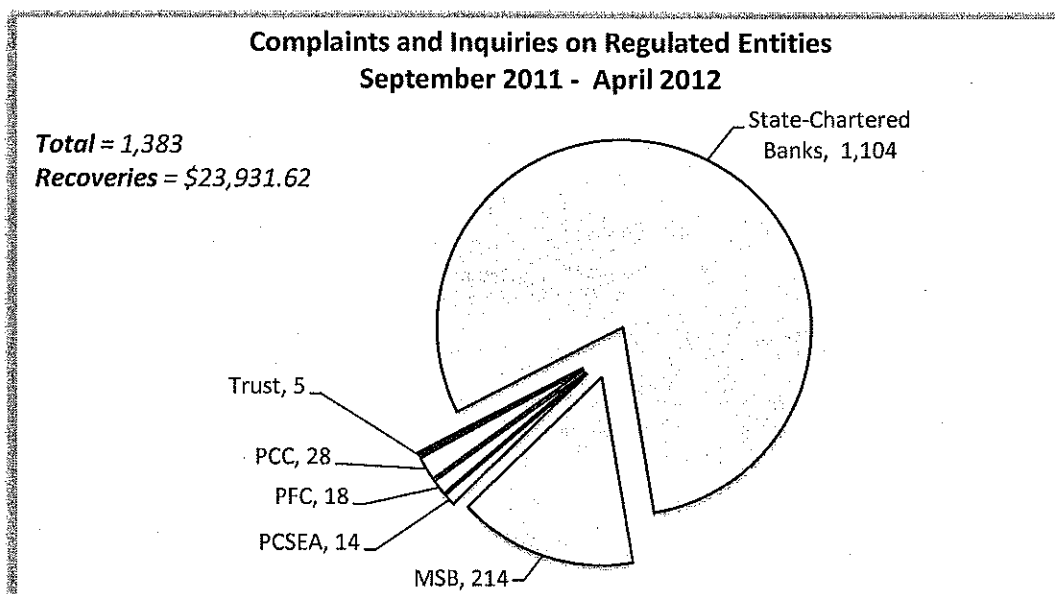
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**To:** Finance Commission Members

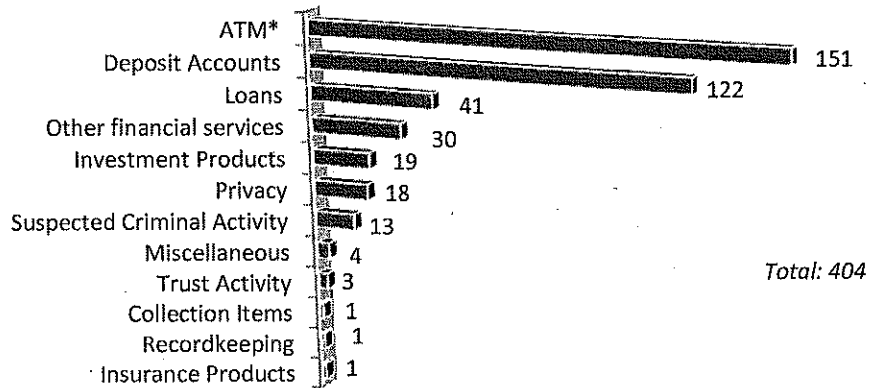
**From:** Wendy Rodriguez, Director of Strategic Support *WR*

**Date:** June 1, 2012

**Subject:** Summary of the Strategic Support Division Activities

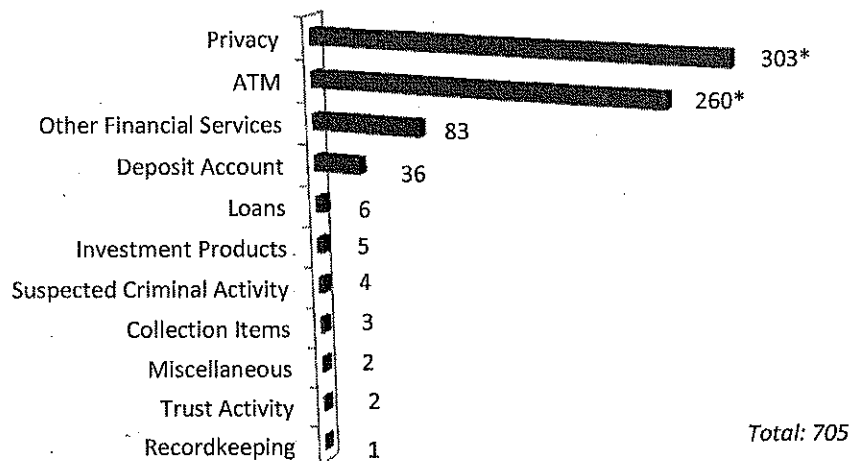


**State-Chartered Banks and Trust Companies  
Complaints by Type  
September 2011 - April 2012**



*\*High activity related to annual privacy notice containing the Department's contact information. Consumer complaints range from needing clarification of the notice to account balance issues and card related problems.*

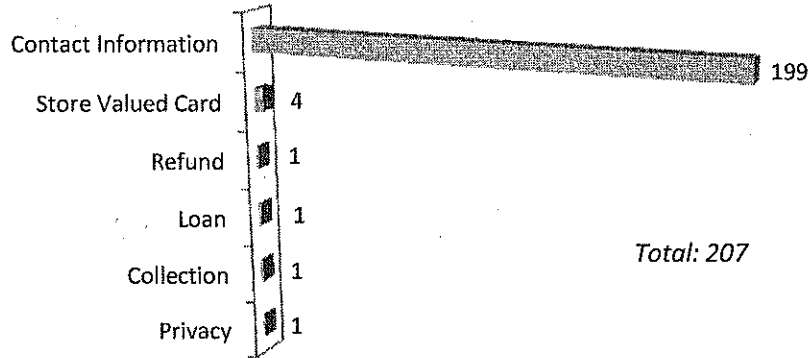
**State-Chartered Banks and Trust Companies  
Inquiries by Type  
September 2011 - April 2012**



*\*High activity related to annual privacy notice containing the Department's contact information. Consumer complaints range from needing clarification of the notice to account balance issues and card related problems.*

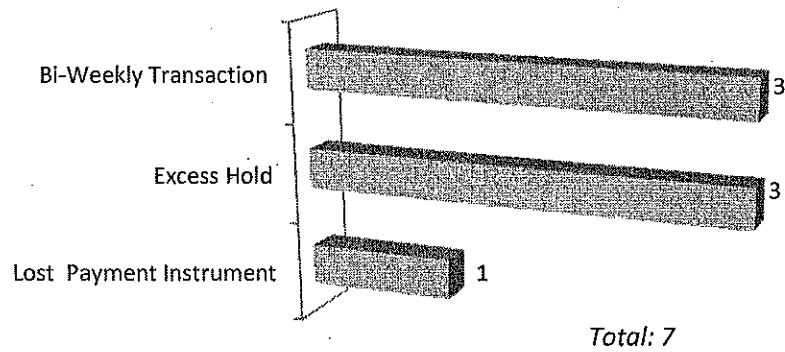
**Money Services Businesses  
Inquiries by Type**

**September 2011 - April 2012**



**Money Services Businesses  
Complaints by Type**

**September 2011 - April 2012**



Average Number of Days to Close a Complaint	
Type	Sept. 2011 – April 2012
State-Chartered Banks	18
Trust*	n/a
PCSEA	1
PFC/PCC	33
MSB	45

\* Response was given on same day as complaint was filed.

CANS Activity March 2008 – April 30, 2012		
Entity	Enrolled	Compromised Accounts Reported
Texas State-Chartered Banks	273	1,986
Texas State-Chartered Savings Banks	27	96
Federal Savings Banks	13	199
State Credit Unions	158	1,738
Federal Credit Unions	229	1,682
National Banks	183	1,035
Out-of-State State-Chartered Banks	14	3
Out-of-State National Banks	7	75
Total	904	6,814

**Other Division Information:**

- The Department's 2013-2017 Strategic Plan is included for review and approval.
- The Customer Service Report was submitted on May 31, 2012 to the Legislative Budget Board and Governor's Budget, Planning, and Policy. It is also displayed on the agency's website.



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Commissioner

## **TEXAS DEPARTMENT OF BANKING**

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### **Memorandum**

**TO:** Finance Commission Members  
**FROM:** Kaylene Ray, General Counsel *AKR*  
**DATE:** June 1, 2012  
**RE:** Legal Division Update

#### **Litigation**

*State of Texas v. Stephenville Memorial Gardens, Inc.*, Cause No. 30853, In the 266th District Court of Erath County, Texas. This case is a petition and application for revocation of charter and appointment of a receiver for Stephenville Memorial Gardens Cemetery. The receiver has filed an application with the court for approval of a contract for sale of the cemetery. However, the buyer has not yet submitted an application to the Department for a certificate of authority to operate the cemetery as a perpetual care cemetery.

*In re Timothy John Gaffney*, Case No. 11-6-634-cag, United States Bankruptcy Court, Western District of Texas (Waco). The Department has a judgment that is close to \$1 million against Mr. Gaffney resulting from the illegal sale of prepaid funeral benefits and failure to apply payments to the contracts. Mr. Gaffney has filed for Chapter 7 bankruptcy and the Department has filed its claim in that proceeding. On April 2, 2012, the Department filed an objection to the discharge of Mr. Gaffney's debt to the Department. A trial has been set on that issue for September 10, 2012.

*Texas Department of Banking v. Greg Abbott, Attorney General of Texas*; Cause No. D-1-GV-11-001906, In the 53<sup>rd</sup> District Court of Travis County, Texas. No recent activity in this Public Information Act appeal.

#### **Contested Case Hearings**

*In the matter of: Marquis Demon Johnson, Individually and as owner of Oscar Johnson Funeral Home Houston, Texas*, Docket No. BE-12-12-036. A series of examinations by Special Audits of the funeral home over a four year period revealed a pattern of outstanding examination violations regarding the failure of management to reconcile the ledgers and records on a quarterly basis and to timely deposit payments made by customers purchasing prepaid funeral services contracts. The funeral home failed to achieve compliance and the same violations continued to occur. A hearing on administrative penalties was held on May 24, 2012. A draft proposal for decision is expected in the next two weeks.

#### **Orders**

During April and May 2012 the Commissioner issued eight orders. The Legal Division assisted with the following final public orders.

Order No. 2012-008, dated 4/17/2012; Order to Cease and Desist from Operating a Perpetual Care Cemetery Without a Valid Certificate of Authority and from Violating Texas Health and Safety Code Section 712.029(c); Myrtlewood Memorial Services, Inc. dba Harlingen-Combes Memorial Cemetery, Combes, TX

Order No. 2012-008a, dated 5/15/2012; First Amended Order to Cease and Desist from Operating a Perpetual Care Cemetery Without a Certificate of Authority and from Violating Texas Health and Safety Code Section 712.029(c); Myrtlewood Memorial Services, Inc. dba Harlingen-Combes Memorial Cemetery, Combes, TX

Order No. 2012-010, dated 5/10/12; Order to Cease and Desist Activity and Pay Restitution; Tyler Esser, Individually, and as owner of All Faiths Funeral Services of Houston, and Fred Esser, Individually and as General Manger of All Faith Funeral Services of Houston, Houston, TX

Order No. 2012-011, dated 5/16/2012; Emergency Order to Cease and Desist from Operating a Perpetual Care Cemetery Without a Valid Certificate of Authority and from Violating Texas Health and Safety Code; Antioch St. John's Cemetery Company dba American Memorial Park and Gerald Weatherall, Sr. (president) and Beverly Randall-Weatherall (vice president), Grand Prairie, TX

Order No. 2012-012, dated 5/18/2012; Order Approving Application for Change of Control, Modified Trust Company Charter, and Family Trust Company Exemption; W.S. Farish & Company, Houston, TX

Order No. 2012-013, dated 5/30/2012; Order Approving Conversion; Frost Bank, San Antonio, TX



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2. Discussion of and Possible Vote to Take Action on the Adoption of Amendments to 7 TAC §25.25, Concerning Conversion from Trust-Funded to Insurance-Funded Benefits (Prepaid Funeral Contracts).

**PURPOSE:** The amendments to §25.25 establish a minimum annual interest rate for conversion annuities that can range between one percent (1%) and three percent (3%), based on prevailing market rates at the time of application, rather than the fixed, two percent (2%) minimum annual rate formerly used. This change adds flexibility in setting guaranteed interest rates used in conversion annuities, to better balance the need for a fair return with the potential for long periods of low interest rates.

**RECOMMENDED ACTION:** No comments were received. The Department recommends that the Commission adopt the amended rule without changes to the proposal as previously published in the *Texas Register*.

**RECOMMENDED MOTION:** I move that we adopt the amendments to 7 TAC §25.25 without changes to the proposal as previously published in the *Texas Register*.

***Title 7. Banking and Securities***  
***Part 2. Texas Department of Banking***  
***Chapter 25. Prepaid Funeral Contracts***  
***Subchapter B. Regulation of Licenses***  
***7 TAC §25.25***

The Finance Commission of Texas (the commission), on behalf of the Texas Department of Banking (the department), adopts amendments to §25.25, concerning conversion from trust-funded to insurance-funded benefits, without changes to the proposed text as published in the May 4, 2012, issue of the *Texas Register* (37 TexReg 3289).

These amendments are adopted to increase flexibility in setting guaranteed interest rates used in conversion annuities, to better balance the need for a fair return with the potential for long periods of low interest rates.

Existing prepaid contracts for trust-funded prepaid funeral benefits may be converted to insurance-funded prepaid funeral benefits under Finance Code, §154.204, if the department finds that the proposed insurance-funded arrangement safeguards the rights and interests of the individuals who purchased the prepaid contracts to substantially the same degree as the trust-funded arrangement proposed to be replaced. Pursuant to former §25.25(c)(9)(A), the funding insurance policy was required to be a fixed annuity that provided guaranteed growth based on a minimum annual interest rate of two percent. This rate created difficulties in the current low interest rate environment.

The amendment to §25.25(c)(9)(A) adds flexibility to the interest rate determination to better balance the need for a fair return

with the potential for long periods of low interest rates. The amendments allow the minimum guaranteed fixed interest rate to be set between one percent and three percent, depending upon the yield of five-year treasury bonds at the time the application is approved. The calculation method is patterned on the manner in which minimum nonforfeiture amounts for certain annuities are calculated under Insurance Code, §1107.055.

Further, for comparison the amendments expand the historical yield table or graph required by §25.25(c)(11) to include annuities sold in this state in the last five years for the purpose of funding new prepaid funeral contracts.

The amendments also make conforming changes to §25.25(c)(16) and (17) and correct cross-reference errors in §25.25(c)(4) and (19).

The Department received no comments regarding the proposed amendments.

The amendments are adopted pursuant to Finance Code, §154.204, which provides for department approval of a conversion from trust-funded prepaid funeral benefits to insurance-funded prepaid funeral benefits, and under Finance Code, §154.051, which authorizes the commission to adopt rules relating to the enforcement and administration of Chapter 154.

**§25.25. Conversion from Trust-Funded to Insurance-Funded Benefits.**

(a) Definitions. Definitions of words and terms in Finance Code, §154.002, are incorporated in this section by reference. The following words and terms have the

## ADOPTION OF AMENDMENTS TO 7 TAC §25.25

Page 2 of 14

following meanings when used in this section, unless the context clearly indicates otherwise.

(1) Aggregate trust funds--The trust funds to be transferred with respect to an individual prepaid contract as of the transfer date, comprised of the paid-in principal plus the earnings attributable to that prepaid contract. As the context may require, the term also refers to the sum of the aggregate trust funds for all prepaid contracts subject to conversion.

(2) Applicant--A permit holder under Finance Code, Chapter 154, who files an application under this section.

(3) Contract beneficiary--The person named in a prepaid contract as the intended recipient of contracted funeral merchandise and services.

(4) Conversion--A transaction under Finance Code, §154.204, and this section, to convert all outstanding trust-funded prepaid funeral benefits under existing prepaid contracts administered by the applicant to insurance-funded prepaid funeral benefits to be administered by the post-conversion permit holder after conversion.

(5) Insurance company--The insurance company designated in an application filed under this section to issue the annuities required for the conversion. The insurance company may also be the post-conversion permit holder if permitted under applicable insurance law and regulations.

(6) Paid-in principal--The amount required to be deposited in trust by the applicant with respect to an individual

prepaid contract pursuant to Finance Code, §154.253. As the context requires, the term may also refer to the total amount deposited in trust by the applicant for all prepaid contracts.

(7) Post-conversion permit holder--The permit holder designated in an application filed under this section to hold and administer the prepaid contracts after conversion. The post-conversion permit holder may also be the insurance company if permitted under applicable insurance law and regulations.

(8) Prepaid contract--A contract for prepaid funeral benefits under Finance Code, Chapter 154.

(9) Purchaser--An individual who purchased a trust-funded prepaid contract that is the subject of an application filed under this section. The purchaser may also be the contract beneficiary. If permitted by the context, the term includes the purchaser's authorized agent.

(10) TDI--Texas Department of Insurance.

(11) Unpaid principal balance--The unpaid portion of the purchase price of a prepaid contract.

(b) Standards for approval and eligibility. The department will not approve a proposed conversion unless the following general requirements have been met.

(1) Standards for approval. The proposed insurance-funded benefits arrangement must safeguard the rights and interests of the purchasers to substantially the same degree as the trust-funded benefits

## ADOPTION OF AMENDMENTS TO 7 TAC §25.25

Page 3 of 14

arrangement sought to be replaced, as provided by Finance Code, §154.204, and this section. An application may be approved or denied without the necessity of a hearing, subject to the right of the applicant or the post-conversion permit holder to request a hearing. Without limiting its ability to consider any matter relevant to the determination of substantial equivalency, the department will not approve a proposed conversion unless:

(A) the form(s) of insurance policy proposed for use in the conversion is a single or flexible premium deferred fixed (not variable) annuity that is structured to protect and preserve the existing rights and interests of the purchaser, including the amount of funds the purchaser would be entitled to receive upon cancellation of the prepaid contract and the amount of funds payable upon maturity of the prepaid contract;

(B) the post-conversion permit holder directly or indirectly controls, is controlled by, or is under common control with the insurance company;

(C) neither the applicant nor the post-conversion permit holder have a record of noncompliance with respect to the requirements of Finance Code, Chapter 154, and this chapter, as evidenced by paragraph (2) of this subsection;

(D) the post-conversion permit holder accepts responsibility for verifying that the prepaid contracts proposed for conversion are performed in accordance with their terms, and undertakes to maintain the records the department requires to determine compliance with Finance Code, Chapter 154, and this chapter; and

(E) the post-conversion permit holder demonstrates the organizational and financial capability to discharge its accepted responsibilities.

(2) Eligibility. At the time the application is filed, processed and approved, the applicant and the post-conversion permit holder must each be in good standing with the department. To be in good standing with the department, the department's most recent report of examination of either permit holder must not cite any violation of applicable laws and regulations or other material deficiencies that have not been remedied or corrected to the satisfaction of the department, and the permit holder must not be delinquent with respect to any fees or filings due to the department. Within 45 days after an application for conversion is filed with the department, the department may conduct an examination of the applicant or the post-conversion permit holder or both before approving or denying the application if an examination has not been conducted within the preceding 12 months or for the purpose of verifying that previously cited violations or other deficiencies have been satisfactorily eliminated or corrected.

(c) Contents of application. An application for conversion must respond to each paragraph of this subsection by number. Overlapping or duplicate responses may be cross-referenced for brevity.

(1) Letter requesting conversion. The applicant shall submit a letter to the commissioner, signed by a duly authorized officer, that:

(A) requests approval of the conversion of the applicant's prepaid contracts;

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(B) requests authorization to transfer the applicant's responsibility for the prepaid contracts to the post-conversion permit holder;

(C) summarizes the amount of aggregate trust funds by depository and account number and the component amounts of paid-in principal and earnings, and requests authorization to transfer the aggregate trust funds from the currently approved depository or trustee to the insurance company;

(D) represents that the applicant is in compliance with Finance Code, §154.301, regarding prepaid contracts presumed to be abandoned, and has filed the reports and delivered funds as required by Finance Code, §154.304; and

(E) if the applicant is not an individual, includes a certified resolution of the applicant's board authorizing the conversion, the application, and the execution of related documents by the submitting officer.

(2) Agreement regarding conversion. The applicant must submit an original, signed copy of the agreement among the applicant, the post-conversion permit holder, and the insurance company regarding the transfer, receipt, and application of trust funds upon conversion that, among other matters, contains the following provisions:

(A) agreement of the parties that all prepaid contracts of the applicant in existence as of the date of the application will be subject to conversion, excluding prepaid contracts that are presumed abandoned under Finance Code, §154.301;

(B) agreement of the insurance company that:

(i) the formula for determining the cash surrender value or cancellation benefit of each annuity to be issued in the conversion will be at least as generous to the purchaser as the formula that would have applied under Finance Code, §154.155, had the prepaid contract not been converted from trust-funded to insurance-funded;

(ii) the face amount of the annuity to be issued with respect to each prepaid contract will not be less than the amount of aggregate trust funds transferred for that prepaid contract;

(iii) for any prepaid contract which is not fully paid and the balance due not included in the annuity described in clause (ii) of this subparagraph, the face amount of the supplemental annuity to be issued may not be less than the unpaid principal balance, and no credit or reduction will be applied to the unpaid principal balance for earnings attributable to paid-in principal under the prepaid contract;

(iv) upon request, a copy of the specifications page of the funding annuity or annuities will be furnished to the purchaser of the prepaid contract to be funded; and

(v) no commissions or other compensation will be paid out of or deducted from the aggregate trust funds to be transferred in the proposed conversion.

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(C) agreement of the post-conversion permit holder with respect to the converted prepaid contracts to:

(i) maintain all records required by §25.10 of this title (relating to Recordkeeping Requirements for Insurance-Funded Contracts);

(ii) verify that each death or cancellation benefit claim under a converted prepaid contract is paid in accordance with Finance Code, Chapter 154, and this chapter;

(iii) verify that each prepaid contract is performed by the funeral provider at maturity in accordance with its terms;

(iv) verify that any additional charges imposed by the funeral provider and collected from the decedent's representatives are for additional services or merchandise not otherwise contemplated by and funded under the prepaid contract and, if not, promptly refund or require the funeral provider to refund any prepaid contract overcharges to the decedent's representatives; and

(v) if within the five-year period following approval of the conversion a purchaser presents a fully executed prepaid contract that was not listed in the applicant's pre-conversion or post-conversion summaries and provides proof of payments made on the contract, take action to cause the insurance company to issue one or more annuities with respect to the previously omitted prepaid contract as if it had originally been included in the conversion or, if cancellation is requested by the purchaser, pay or take action to cause the purchaser to be paid the cancellation benefit

due. The maximum potential responsibility imposed by this clause is 5.0% of the aggregate trust funds transferred, except that if 5.0% of the aggregate trust funds is:

(I) less than \$5000, the maximum potential responsibility imposed by this clause is \$5,000;

(II) greater than \$20,000, the maximum potential responsibility imposed by this clause is \$20,000.

(3) Compensation to insiders. The applicant must submit a written disclosure of the estimated total commissions and other compensation to be paid by the insurance company in connection with the conversion to each insurance agent that controls, is controlled by, or is under common control with the applicant or a funeral provider under any of the prepaid contracts to be converted, expressed as a percentage, dollar amount, or both, and the identity of each such agent.

(4) Agreement of post-conversion permit holder and applicant. The applicant must submit a written agreement between the post-conversion permit holder and the applicant that, at a minimum, requires the applicant to relinquish the individual prepaid contract ledgers formerly maintained by the applicant under §25.11 of this title (relating to Recordkeeping Requirements for Trust-Funded Contracts) and obligates the post-conversion permit holder to maintain such ledgers to reflect the paid-in principal and the unpaid principal balance under each converted prepaid contract.

(5) Agreements between post-conversion permit holder and funeral providers. The applicant must submit the

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written agreement between the post-conversion permit holder and each person designated as the funeral provider under any prepaid contract to be converted that, at a minimum:

(A) sets forth the nature and scope of the relationship between the permit holder and the funeral provider and the respective rights and responsibilities of the parties with respect to the prepaid contracts of that funeral provider, including allocation of responsibilities for refunding any prepaid contract overcharges identified by the permit holder or the department;

(B) requires the funeral provider to perform and deliver the funeral benefits under each converted prepaid contract of that funeral provider in accordance with its terms;

(C) requires the funeral provider to provide the post-conversion permit holder with the documentation necessary to enable the permit holder to maintain the records required by Finance Code, Chapter 154, and §25.10 of this title; and

(D) obligates the parties to protect any nonpublic personal financial or health information of the purchaser and contract beneficiary under the prepaid contract in compliance with applicable law.

(6) Agreement of post-conversion permit holder and insurance company. If the proposed post-conversion permit holder is not the insurance company, the applicant must submit a written agreement between the post-conversion permit holder and the insurance company that, at a minimum, requires the insurance company to provide the post-conversion permit holder with the

documentation necessary to enable the permit holder to maintain the records required by §25.10 of this title. The agreement must also obligate the parties to protect any nonpublic personal financial or health information of the purchaser and contract beneficiary under each converted prepaid contract and the owner and insured under each annuity issued in the proposed conversion in compliance with applicable law.

(7) Commitment of insurance company. If the post-conversion permit holder is not the insurance company and is unable to independently demonstrate that it has the organizational and financial resources to discharge its permit holder responsibilities, or otherwise intends to rely on the insurance company to provide such resources, the insurance company or its insurance holding company must commit to the department in writing to take all necessary steps to maintain the existence of the current or a successor post-conversion permit holder, cause such permit holder to annually renew its permit if renewal is required by Finance Code, §154.107, and provide adequate resources to such post-conversion permit holder to enable it to maintain the financial condition and general fitness necessary to discharge the post-conversion permit holder's responsibilities under Finance Code, Chapter 154, and this chapter.

(8) Commitment of applicant. The applicant must commit to the department in writing to obtain and annually renew a permit under Chapter 154 and assume the post-conversion permit holder's responsibilities with respect to each converted contract for any year in which any converted contract remains outstanding and



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the post-conversion permit holder or a duly licensed successor fails to renew its permit as required with respect to the converted contracts, as evidenced by a final order revoking the permit. The commitment must obligate the applicant to submit its completed application with all required fees not later than the 31st day after the date the department notifies the applicant in writing of the facts that require licensure under the commitment.

(9) Form of annuity. The applicant must submit a copy of the form(s) of annuity proposed to be issued as part of the conversion. The submitted form(s) must be accompanied by a copy of the TDI notice of action approval letter. The applicant and not TDI is responsible for ensuring that the form of annuity complies with this section. Among other matters, the annuity must:

(A) provide guaranteed growth of the death benefit based on a fixed annual interest rate, compounded annually on gross premiums paid beginning in the first year of the policy, that is at least equal to a rate determined as the lesser of:

(i) 3.0%; and

(ii) the average of the five-year Constant Maturity Treasury Rate reported by the Federal Reserve Board of Governors for the 90 calendar day period ending not more than 30 days prior to the date of the commissioner's order of approval, rounded to the nearest 1/20th of one percent, less 125 basis points, but not less than 1.0%;

(B) provide a formula for determining cash surrender value or cancellation benefit that will be at least as

generous to the purchaser as the formula that would have applied under Finance Code, §154.155, had the prepaid contract not been converted from trust-funded to insurance-funded;

(C) provide a death benefit for the duration of the prepaid contract that equals the sum of the aggregate trust funds transferred at conversion, all future premiums paid, and accumulated growth thereon as provided by subparagraph (A) of this paragraph, provided that the death benefit can never be less than the amount that would have been available under the prepaid contract on the date of conversion had the prepaid contract not been converted from trust-funded to insurance-funded; and

(D) not include any provision that allows for contesting coverage or limiting death benefits, refers to or requires a physical examination, or otherwise operates as an exclusion, limitation, or condition on payment of death benefits other than provisions requiring submission of proof of death or surrender of the annuity at the time the annuity matures or is canceled.

(10) Federal income tax treatment. The applicant must submit a written summary describing the pre-conversion, federal income tax status of the purchasers' trusts, in the aggregate, as either qualified funeral trusts under 16 U.S.C. §685 or grantor trusts, for the preceding taxable year. Disclosure of differing treatment of individual purchaser trusts is not required if the summary identifies and quantifies the percentage of purchaser trusts treated as grantor trusts and qualified funeral trusts. The applicant must also describe the post-conversion manner in which taxable income arising from the annuities will be reported

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for federal income tax purposes, including taxable income arising from payment of cash surrender value.

(11) Past performance. For purposes of this paragraph, the annual growth under an annuity equals the growth rate credited by the insurance company to the death benefit for the year. The applicant must submit separate historical yield tables or graphs reflecting the annual rate of growth in the death benefit, expressed as a percentage for each year of the most recent five-year period, under:

(A) previously issued annuities similar to the form of annuity proposed to be issued by the insurance company in the proposed conversion, to the extent such annuities were in existence in those periods; and

(B) annuities sold by the insurance company in this state during the most recent five-year period for the purpose of funding new prepaid funeral contracts.

(12) Form of assignment. The applicant must submit a copy of the form of assignment, if any, to be used in assigning annuity rights or proceeds to the post-conversion permit holder.

(13) Qualifications of post-conversion permit holder. With respect to the post-conversion permit holder, the applicant must submit:

(A) if the proposed post-conversion permit holder is not also the insurance company, a copy of the post-conversion permit holder's most recent annual financial statements and the most current year-to-date financial statements;

(B) a list of all previous conversions in this state accepted by the post-conversion permit holder and, with respect to each conversion, the date of the order approving the conversion and the date that the converted prepaid contracts were formally transferred to the post-conversion permit holder;

(C) a summary of the number and aggregate purchase price of all prepaid contracts administered by the post-conversion permit holder as of the end of the immediately preceding calendar year;

(D) a description of how the prepaid contracts to be converted will be administered by the post-conversion permit holder, including a description of activities or functions, other than delivery of funeral services and merchandise by the designated funeral provider, that will be outsourced and the contractor that will perform such activities or functions; and

(E) if any contractor named in response to subparagraph (D) of this paragraph directly or indirectly controls, is controlled by, or is under common control with the post-conversion permit holder, a summary of the contracting relationship for each of the preceding three fiscal years that includes a description of the services performed and the compensation paid by the post-conversion permit holder.

(14) Qualifications of insurance company. With respect to the insurance company, the applicant must submit:

(A) a letter from the insurance company addressed to the department, dated not more than 60 days prior to the date the application is filed, representing that the

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insurance company is in good standing and currently authorized to conduct the business of insurance in this state;

(B) to the extent available, a list of the current financial strength ratings of the insurance company determined by A.M. Best Company, Standard & Poor's, Weiss Research, Duff & Phelps, and Moody's Investors Service; and

(C) a list of all previous conversions in this state that were funded by the insurance company and, with respect to each conversion, the date of the order approving the conversion and the date that trust funds were formally transferred to the insurance company.

(15) Notice to purchasers. The applicant must submit the proposed form of public notice required by subsection (e)(2) of this section and each proposed letter regarding the proposed conversion to be sent to purchasers from the applicant, the post-conversion permit holder, or the insurance company, for approval by the department. The proposed form of notification letter from the applicant must:

(A) briefly and fairly disclose the terms of the proposed conversion in a manner that is not misleading and that enables the purchaser to understand the terms of the proposed conversion and the impact on the purchaser and the purchaser's contract;

(B) conspicuously disclose, by means of bolded type within a bordered text box or another method acceptable to the department, the purchaser's right under Finance Code, §154.204(b), to decline the conversion and remain in the existing trust-

funded funeral benefit arrangement by filing a written request with the department within 60 days;

(C) inform the purchaser that a copy of the specifications page of the funding annuity is available upon request, if such notice is not contemporaneously provided by the insurance company in a separate letter;

(D) advise the purchaser that questions or complaints regarding the prepaid contract or the proposed conversion may be directed to the Texas Department of Banking, 2601 North Lamar Boulevard, Austin, Texas 78705; 1-877-276-5554 (toll free);

(E) disclose that the prepaid funeral guaranty fund will no longer guarantee performance of the prepaid contract after conversion, that a successor funeral provider may not agree to provide the previously selected funeral services and merchandise for the same price specified in the prepaid contract with the original funeral provider, and at the option of the applicant, disclose as an aid for comparison that payment of the funding annuity, but not performance of the contract itself, will be guaranteed by the Texas Life, Accident, Health, and Hospital Service Insurance Guaranty Association after conversion (provided that, if approved by the department, such disclosure will not be deemed a violation of Insurance Code, §463.451);

(F) not contain promotional statements or claims that express subjective rather than objective views of the merits or benefits of conversion;

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(G) if the prepaid contract allows the contract beneficiary to be changed and the annuity contract does not allow the annuitant to be changed, disclose that the prepaid contract beneficiary may no longer be changed after the funding annuity is issued; and

(H) explain any change in federal income taxation related to cancellation and maturity resulting from the conversion that is anticipated to affect the purchaser.

(16) Pre-conversion summary. The applicant must submit a pre-conversion summary pertaining to each prepaid contract to be converted, determined as of a date no earlier than 30 days prior to the date the application is filed, with totals for all prepaid contracts to be converted, if applicable, addressing each of the following categories:

(A) name and, if available, date of birth of the purchaser;

(B) date of contract;

(C) contract purchase price;

(D) paid-in principal;

(E) unpaid principal balance, if any;

(F) accumulated earnings;

(G) cancellation benefit due to the purchaser, assuming cancellation were to occur on the calculation date;

(H) amount eligible to be withdrawn from the trust fund by the applicant upon death of the contract

beneficiary, assuming death were to occur on the calculation date;

(I) amount retained by the applicant under Finance Code, §154.252; and

(J) the guaranteed minimum interest rate to be applied to the death benefit calculated as if the date of the application were the date of the commissioner's order of approval.

(17) Pro forma post-conversion summary. The applicant must submit a pro forma post-conversion summary pertaining to each prepaid contract as if converted, determined as of the same date as the pre-conversion summary, with totals for all prepaid contracts, if applicable, addressing each of the following categories:

(A) name of annuitant;

(B) contract purchase price;

(C) paid-in principal;

(D) unpaid principal balance, if any;

(E) the amount of transferred trust funds applied to the premium for the annuity;

(F) amount retained by the applicant under Finance Code, §154.252;

(G) cash surrender value of each annuity, assuming the annuity were to be surrendered on the calculation date;

(H) death benefit under each annuity, assuming death were to occur on the calculation date; and

(I) the guaranteed minimum interest rate to be applied to the death benefit, including the actual calculation as determined under paragraph (9)(A) of this section.

(18) Voluntary cancellation of permit. If the applicant will not sell trust-funded prepaid contracts or administer previously sold trust-funded prepaid contracts after the conversion, the applicant must submit a completed form to voluntarily cancel its trust-funded permit. The applicant's voluntary cancellation will not be processed unless the conversion is approved, and will not be effective until the department completes the close-out examination of the applicant.

(19) Application fee. In connection with an application submitted under this section, the applicant must submit the conversion application fee required by §25.23 of this title (relating to Application and Renewal Fees).

(20) Side agreements. To the extent not otherwise required by this subsection, the applicant must submit copies of any other agreements between or among the applicant, a funeral provider, the post-conversion permit holder, and/or the insurance company that contain contractual provisions or informal understandings or undertakings addressing any aspect of the proposed conversion or the future relationship among the applicant, a funeral provider, the post-conversion permit holder, and/or the insurance company with respect to any converted prepaid contract.

(d) Consideration of application; hearing. If the application is deficient, the department may require any person connected with the proposed conversion to submit additional information. An application may be approved or denied without the necessity of a hearing, subject to the right of the applicant or the post-conversion permit holder to request a hearing.

(1) Conditions in order approving conversion. An order approving conversion will impose certain conditions that are not subject to objection, as described in subsection (e) of this section. The order may also impose other, nonstandard conditions specific to the conversion at issue. The applicant or the post-conversion permit holder must submit a written request for hearing pursuant to paragraph (2) of this subsection if any nonstandard condition in the order is objectionable, in which case the order is deemed to be a denial. Consummation of the conversion transaction constitutes confirmation of acceptance by the applicant, the post-conversion permit holder, and the insurance company of any conditions imposed by the order and is considered for all purposes an agreement with the department enforceable against the applicant, the post-conversion permit holder, and the insurance company.

(2) Hearing. The applicant or the post-conversion permit holder may file a written request for hearing with the commissioner on or before the 30th day after the date of the order denying the application, or an order imposing nonstandard conditions objectionable to the applicant or the post-conversion permit holder, stating with specificity the reasons the applicant alleges that the decision of the

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department is in error. The request for hearing will be forwarded to the administrative law judge who must enter appropriate orders and conduct the hearing on or before the 60th day after the date the request for hearing was received, or as soon as is otherwise reasonably possible, under Chapter 9 of this title (relating to Rules of Procedure for Contested Case Hearings, Appeals, and Rulemakings) and Government Code, Chapter 2001. The applicant or the post-conversion permit holder has the burden of proof to demonstrate that the proposed insurance-funded prepaid funeral benefits safeguards the rights and interests of each affected purchaser to substantially the same degree as the existing trust-funded prepaid funeral benefits sought to be replaced. A denial of an application may not be appealed until a final order is issued.

(e) Standard conditions in order approving conversion. An order approving conversion will impose six required conditions that are not subject to objection. Failure to satisfy any of these conditions constitutes a violation of an order of the commissioner subject to possible enforcement action under Finance Code, Chapter 154.

(1) The order approving conversion will prohibit issuance of the annuities prior to the expiration of the time period for a purchaser to decline conversion, including any extended time period required by paragraph (4) of this subsection, except that the annuities may be issued prior to that date if expiration of the time period will occur during the free look period or if a purchaser electing to decline conversion will not be required to pay an early withdrawal penalty for cancellation of the annuity.

(2) Pursuant to Finance Code, §154.204(b), the order approving conversion will require the applicant to notify purchasers of the proposed conversion by the following means:

(A) The notification letter from the applicant described by subsection (c)(15) of this section must be sent to purchasers by certified mail or another form of mail that requires or provides proof of delivery to the last known address of the purchaser.

(B) The applicant must publish a one-time public notice in a newspaper of general circulation in the county in which the applicant is located, or in another publication or location as directed by the department, as evidenced by a publisher's affidavit attesting to the date of publication, advising purchasers of trust-funded prepaid contracts from applicant of the pending conversion, the right of a purchaser to decline conversion, and the manner in which a purchaser may obtain more information about the purchaser's rights and options regarding the conversion.

(3) The order approving conversion will provide that a prepaid contract for which the notification letter is returned unclaimed may not be converted to the insurance-funded funeral benefit arrangement approved in the order unless the requirements of this paragraph are met.

(A) With respect to each notification letter returned unclaimed because the address is incorrect, the addressee is unknown or has moved without leaving a forwarding address, or the addressee's forwarding order has expired, the applicant must search for a new address for the purchaser using available non-fee

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based resources. If a new address is located, the applicant must resend the notification letter one time in the manner required by subsection (e)(2)(A) of this section.

(B) With respect to each unclaimed notification letter for which a new address is not located and with respect to each re-mailed notification letter that is returned unclaimed, the applicant must review the related contract file in light of the returned letter to verify or change its prior determination that the contract should not be presumed abandoned under Finance Code, §154.301, and must retain documentation evidencing its review for examination by the department. A prepaid contract subject to this paragraph may be converted to the insurance-funded funeral benefit arrangement approved in the order only if the applicant makes a new affirmative finding that the contract should not be presumed abandoned. On or before the 120th day after the date of the order, the applicant must submit a report to the department summarizing its activities under this subparagraph and reporting the basis for findings made.

(4) The order approving conversion will require the post-conversion permit holder, on or before the 120th day after the date of the order, to submit to the department a notarized statement attesting that the annuities have been issued and funded on behalf of the purchasers listed in the pro forma post-conversion summary included in the conversion application and disclosing the date that the notification letters included in the conversion application were mailed to the purchasers.

(5) The order approving conversion will require the post-conversion permit

holder, on or before the 120th day after the date the trust funds are transferred as authorized by the order, to submit to the department a final post-conversion summary pertaining to each converted prepaid contract, determined as of the conversion date, with totals for all prepaid contracts, if applicable, addressing each of the following categories:

(A) name of annuitant;

(B) policy number of the annuity issued to the annuitant, or of each annuity if a supplemental annuity is also issued;

(C) contract purchase price;

(D) paid-in principal;

(E) unpaid principal balance, if any;

(F) the amount of transferred trust funds applied to the premium for each annuity;

(G) amount retained by the applicant under Finance Code, §154.252;

(H) cash surrender value of each annuity, assuming the annuity were to be surrendered on the conversion date; and

(I) death benefit under each annuity, assuming death were to occur on the conversion date.

(6) The order approving conversion will require the conversion transaction to be fully implemented and completed on or before the 150th day after the date of the conversion order.

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This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on June 15, 2012.